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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 825

OSMOND Y. LADD and PAUL H. TODD,

Petitioners,

—*vs.*—

BARTHOLOMEW A. BRICKLEY, Trustee of International Hydro Electric System, SECURITIES & EXCHANGE COMMISSION, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR ETHEL KRESBERG, SAMUEL KRESBERG AND MILDRED KRESBERG, HOLDERS OF INDENTURES OF INTERNATIONAL HYDRO ELECTRIC SYSTEM, INTERVENORS-RESPONDENTS.

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Opinions Below.

The District Court rendered no opinion. The opinion of the Circuit Court of Appeals, filed November 14th, 1946. is not yet reported.

Jurisdiction.

Jurisdiction is invoked under Section 240(a) of the Judicial Code, as amended (Section 347(a) of Title 28 of the U. S. Code).

Principal Questions Involved.

The principal questions involved are two. 1—Were formal findings of fact and conclusions of law, other than those contained in the decree affirming the compromise, required to be made by the District Court? 2—Was there an abuse of discretion in approving of the compromise?

Argument.

POINT I.

Findings of fact and conclusions of law by the lower Court were unnecessary. Federal Rule 52(a) does not apply to the instant proceeding.

Federal Rule 52(a) reads as follows:

> "In all actions tried upon the facts without a jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court."

The rule is by its express language limited to actions in which there are issues of fact triable by the Court without a jury and to applications for interlocutory injunctions. It relates to suits in which evidence is presented by the opposing parties and the court is required to pass upon factual issues before it can render its decision.

An examination of the cases cited by the appellants in Point I of their brief (pp. 38 to 41 incl.) discloses that all of them deal either with judgments rendered by the Court after trial of issues of fact and law, or with applications for injunctions; with the one exception of *Kelley* v. *Everglades District,* 87 Law Edition 1485 (p. 41 of app. br.), which dealt with a composition in bankruptcy; the Court there in its opinion expressly adverted to the fact that Rule 52(a) was made applicable to the proceeding in bankruptcy there involved by General Order in Bankruptcy #37.

The reason for the rule would seem perfectly clear where issues of fact are presented to the court and proof is submitted. The facts upon which the court's decision is based must be specially stated in appropriate findings, as must also be the court's conclusions of law predicated upon those facts. In those cases no question of the exercise of discretion on the part of the court is involved.

In the instant case the court was not called upon to try or determine any factual issue nor to pass judgment on either the claims of the appellants or the defenses of International Paper Company. All the court was required to determine was whether, in its opinion, there was sufficient doubt as to the likelihood of success in the actions and, if recovery was not certain, whether the amount of settlement proposed and recommended by the plaintiff-trustee and his counsel and the S. E. C. was or was not a reasonable one under all of the circumstances.

Where the court is not under a duty to resolve facts presented to it in favor of one or the other of the litigants, but the matter merely calls for the exercise of the court's discretion, Rule 52(a) does not apply.

POINT II.

The complex legal and factual questions involved in the transactions complained of and the uncertainty of recovery justified the Court below in approving the settlement.

We shall not enter upon a detailed recital of the relations between the two Paper Companies and Hydro or the transactions complained of, but shall briefly refer to the two transactions which constitute the bulk of the claims upon which the actions against International Paper Company are predicated. They took place in 1929 and 1932 respectively.

Re The 1929 Transaction.

This first transaction embraced the organization of International Hydro Electric System as a Massachusetts trust by International Power and Paper Company and International Paper Company (R. 273). Prior to such organization, and as part of the plan pursuant to which Hydro was organized, International Power and Paper and International Paper had arranged for the transfer to Hydro of a block of stock in New England Power Association for a consideration to be paid by Hydro of $22,800,494., plus an option for additional stock of New England Power Association for which Hydro was to pay about $35,000,000 (R. 264, 265). The only stock issued by Hydro upon its organization was 500,000 shares of its Class B stock for which it received from International Paper and Power $10,000,000. in cash, 475,000 shares of its Class A stock which were issued to International Paper and Power and paid for by it at the rate of $41. per share, and 2,000,000 shares of its common stock which were issued to International Paper as part of the consideration for the foregoing transfers (R. 264, 265).

It will be seen, therefore, that at the time of the organization of International Hydro Electric System no stock was issued to any outsider and that the only parties interested were International Paper and Power Company and International Paper Company, as promoters, on the one side, and the International Hydro Electric System on the other.

Viewing International Paper and Power and International Paper as promoters in the foregoing transactions, we find that there is by no means a certainty that a recovery will be obtained.

We have on the one hand the rule laid down by the U. S. Supreme Court in *Old Dominion Company* v. *Lewisohn,* 210 U. S. 206, 52 Law Ed. 1025, to the effect that, where the promoters are both the sellers and the buyers, and all of the stock of the corporation is issued to the promoters and none sold to the public, interests that entered into the situation subsequent to the organization, can not complain of any transaction that occurred as part of the promotion of the enterprise. The Court in its decision states:

> "At the time of the sale to the plaintiff, then, there was no wrong done to anyone. Bigelow, Lewisohn, and their syndicate were on both sides of the bargain, and they might issue to themselves as much stock in their corporation as they liked in exchange for their conveyance of their land" (Law Ed. p. 1029).

In *Ball* v. *Breed, Elliot and Harrison,* 294 Fed. 227, it was held that no cause of action accrues to the corporation because of the subsequent sale by the promoters of their stock to the public.

The court quoting from *Ehrich on Promoters,* Section 120 states (p. 231):

> "It is now established by an almost unbroken line of decisions that, if the promoters themselves take

the entire share capital of the corporation and then sell the shares to outside parties, there is no fraud upon the corporation, and no basis of complaint by it, no matter what profits the promoters may derive from the transaction. * * *"

(p. 232) "If there is any fraud in a subsequent sale of the shares, the cause of action arising therefrom is personal to the purchasers. The matter is one between these purchasers and their vendor, and no cause of action results to the corporation therefrom."

See also:

Arn v. *Dunnett, et al.*, 93 Fed. 2nd, 634.

We are not unmindful that there are authorities supporting the claims advanced in the action by the Trustee and in the *Ladd* and *Todd* actions against International Paper. We find that the Supreme Court of Massachusetts, in *Old Dominion Company* v. *Bigelow*, 203 Mass. 159, has held to the contrary, where the promoters at the time of the inception of the enterprise had in mind a subsequent sale of stock to the public. Likewise in *McCandless* v. *Furlaud*, 296 U. S. 140, 80 Law Ed. 121, an action by a Receiver of the corporation was upheld. That case, however, seems to be distinguishable, since the court there apparently based its decision to a large extent upon the fact that the corporation was rendered insolvent by the fraudulent acts of its promoters. No such situation is present in the instant case.

We have referred to the Massachusetts case of *Old Dominion* v. *Bigelow, supra,* as going farther than *Old Dominion* v. *Lewisohn, supra,* in holding promoters liable. In the former about seven years had elapsed since the transaction complained of had occurred. It will be noted that while a recovery was allowed, rescission was denied. In the instant

case the time that has elapsed since the transactions complained of is 17 years with respect to the 1929 transaction and 14 years with respect to the 1932 transaction. If the complainants here were to be denied rescission and relegated to their claim for damages, their recovery may be limited to the difference between the market value of the properties acquired by Hydro and the price paid therefor, which may not even approach the amount of $10,000,000 offered here in settlement.

It is obvious that there may be a legitimate doubt in the mind of anyone exercising an unbiased judgment as to which line of cases would control.

Re The 1932 Transaction.

As regards that transaction, in which International Paper and its subsidiaries transferred to Hydro and its subsidiaries certain water powers for a price of upwards of $31,000,000, we find that the negotiations were protracted, covering the period of a year or more, during which time the number of directors of Hydro were successfully increased from 7 to 9 (R. 283), from 9 to 13 (R. 283), and again from 13 to 20 (R. 285). The price originally placed upon the properties by International Paper was in excess of $37,000,000 (R. 286). Due to objections on the part of some of Hydro's directors, the price was finally reduced and agreed upon at $31,797, 610.39 (R. 289). It will undoubtedly be most difficult to prove that the Board as finally constituted was under the domination of International Paper or that the transaction was not at arms' length or that the profit accruing to International Paper was unconscionable.

The fact that some of or even a majority of directors of Hydro may have been elected at the instance of International Paper does not in and of itself establish that their judgment in approving the transaction was biased.

Everett v. *Phillips*, 288 N. Y., 227, 236.

Fully 11 years had elapsed before the first of the suits on behalf of Hydro against International Paper were instituted. We are faced with the questions of ratification, lapse of time and laches, as well as the difficulty of establishing the right to rescission or to damages. It must be obvious that the certainty of recovery is by no means clear.

POINT III.

The unanimous judgment of the trustee, his counsel and other independent counsel, coupled with the recommendations of the Securities and Exchange Commission, should weigh heavily in the consideration as to whether the District Court abused its discretion.

Prior to the appointment of Mr. Brickley as special counsel, appellant Todd, who was then a director of Hydro, had demanded that Hydro take action against International Paper. Hydro then retained Messrs. Ropes, Gray, Boyden and Perkins, a firm of Massachusetts attorneys of high professional standing, to make investigation of the claims presented by Mr. Todd and to give their opinion as to the advisability of instituting suit. Their opinion will be found in the record on appeal (Vol. 2, Pet's. Exh. 8, pp. 568 to 769). In it, after an apparently thorough analysis of the history of the transactions and the law applicable thereto, they reached the conclusion, and so advised Hydro, that an action against International Paper could in all likelihood not succeed, and hence was not advisable. At about the same time an opinion was requested of Mr. Dodge of the firm of Palmer, Dodge, Wilkins and Davis, another well known firm of Massachusetts attorneys, and his opinion in which he reached a similar conclusion will be found in the record (Vol. 2, Exhs. 9, 9A and 9B, pp. 770 to 806).

Subsequently Mr. Brickley was appointed special counsel by the Court below to investigate the charges against In-

ternational Paper and to report to the Court thereon. He made a most exhaustive study of the situation, including not only the study of documentary evidence, but also the examination of witnesses. On the basis of such investigation he recommended to the Court that suit be brought. Thereafter he was appointed the Trustee for the purpose, among other things, of instituting such suit. Suit was thereafter instituted. Pending the action negotiations for a settlement were started. Mr. Brickley succeeded in having the settlement offer increased from an original amount of $500,000. to the sum of $10,000,000., plus a loan of $3,000,000 to one of Hydro's subsidiaries, which he and his counsel deemed an acceptable compromise of the claims in controversy (R. 387).

The Securities and Exchange Commission took the position on the hearings below that, while it was not purporting to give an opinion with respect to the merits of the claims or defenses, nevertheless it thought the setlement should be approved (R. 459 to 466).

Having due regard to the opinions of Messrs. Ropes, Gray, Boyden & Perkins, and Messrs. Palmer, Dodge, Wilkinson & Davis, as to the impossibility of recovery, and the opinions of Mr. Brickley, Mr. Hoar and Mr. Langenbach, and the recommendations of Securities & Exchange Commission as to the advisability of the settlement, it seems to be the better part of discretion to accept the settlement, rather than to run the risk of protracted litigation, as to the successful outcome of which counsel of standing have expressed strong doubt.

We must also bear in mind that Mr. Brickley in his capacity as Trustee for Hydro, and as an arm of the Court, and the Securities & Exchange Commission, a governmental agency, created for the protection of the investing public, are perhaps the only parties to this proceeding not actuated by any personal motive and free from partisan bias.

The careful and painstaking consideration given by Mr. Brickley to every phase of the problems affecting the trust estate and the justification for his final judgment on the matter in issue cannot perhaps be better evidenced than by letting the testimony given by him at the hearing on the proposed settlement speak for itself. We quote from it the following:

Page 369. In answer to questions as to why he considered the offer sufficient:

> A. Because I think there are very serious questions on the facts and very serious questions on the law, and that the payment of $10,000,000 at this time is such a sum as we should accept under all the circumstances.

At page 370:

> The Securities and Exchange Commission has been kept informed of every fact in connection with this matter since I have been appointed trustee.

At page 371:

> I considered every fact which came to my attention. from whatever source it came. I considered the law involved. I weighed the facts and the law against the offer which we had, and as a result of that weighing, I made the recommendation which now appears in this case.
>
> Q. Well, to what extent has your consideration of the law guided your opinion in recommending this settlement? A. I cannot give you the percentage, but I considered it very seriously.
>
> Q. To what extent did you consider the Statute of Limitations? A. To some extent.

Q. How did that bear on your final conclusion,—your consideration of the Statute of Limitations and the effect of it? A. It had some influence.

Q. How much?

The Court: Let me ask a question. Was there a serious question with respect to the Statute of Limitations in this case, in your judgment?

Mr. Brickley: I should say, your Honor please, that there is a serious question so far as the application of the statute was considered.

The Court: Then it was considered, and the judgment of Mr. Brickley was that it involved a serious question.

At page 377:

Q. Now, you haven't in any other respects than those in which I asked you specifically, changed your views as stated in your report as special counsel? A. Well, I cannot answer that question specifically, Mr. Whiteside. All I can say to you is this: that having been associated with this case for about two years, and very closely associated with it, and having listened to anyone who wanted to speak to me about it, and having had the benefit of a very extensive investigation by the Securities and Exchange Commission, which included access to the international Paper Company books, and having in mind the uncertainties of the facts and the uncertainties of the law, I reached a conclusion that it was good judgment for Hydro to accept $10,000,000 plus a loan of $3,000,000. That, as nearly as I can put it, states my position.

At page 379. Discussing the aid given him by the S. E. C.:

* * * The fact is that the Securities and Exchange Commission, as a result of my request, assigned certain of its lawyers and accountants * * *. And they spent, as I recollect it, between four and five months examining, digesting, and discussing with me, facts which they acquired as a result of their investigation of the books of the Paper Company and the Hydro System, and from inquiry they made in connection with Canadian matters.

Q. And that was all while you were still special counsel and before you brought your suit? A. No, sir.

Q. They have given you material since? A. It has continued up to date. As a matter of fact, a great deal of the result of the efforts of the SEC has been conveyed to me orally, in discussions I have had with members of the staff. * * * I want to make it very plain that before I made this recommendation I considered every fact which I had, which had come to me, in writing, orally, as a result of my own investigation; and I considered the law as I understood it in the application to the facts which we had. And it was as a result of those things, plus a consideration as to the likelihood of recovery, plus the beneficial or unfavorable effect upon Hydro in connection with this settlement—and I took into consideration everything that I could conceivably take, and then made up my mind as to what I should do.

At page 387. In answer to a question by Mr. Whiteside:

A. My recollection, if your Honor please, is that the first offer was about a half a million dollars and I think then as a result of discussions and as a result of two or three conferences we reached a point where we had an offer of $3,000,000, and I think as the result of further discussions we reached a point where we had an offer of $5,000,000, and as a result of further discussions we

reached a point where we had an offer of seven and a half million dollars, at which time we were told that was the limit which would be recommended, and we could accept it or reject it, and without going into further or greater detail I should say that we had a subsequent conference which resulted in our getting an offer of ten million dollars, I mean we were presented with another amount, but we sought a further conference as a result of which we were able to add to that the loan of $3,000,000 to the Hudson River Power, and I felt that when we reached that point the Paper Company would absolutely stop, and we could not get one additional dollar, and that therefore it was then incumbent upon me to report the matter to the Court and to recommend it or to refuse to recommend it.

The Securities & Exchange Commission which conducted its own independent investigation, and through its staff fully collaborated with Mr. Brickley and his counsel reached a conclusion fully supporting Mr. Brickley's position. The following excerpts from the statement of Mr. Yohalem, who represented the Commission at the hearing, will show the reasons which prompted it to favor the acceptance of the proposed settlement:

At page 459:

"The court is of course familiar and recalls the fact that one of the considerations which led the Commission to apply to this court in 1943 for enforcement of its 11-B-2 order through these proceedings was because of the history of the transaction between the Paper Company and I. H. E. S. and because of the pendency of these claims by or on behalf of I. H. E. S. against the Paper Company.

"I don't think it is necessary for me to again recite in any great detail the large amount of work, investigation and study that these claims have gotten from the Commission staff, from Mr. Brickley and later from counsel."

At page 461:

"* * * Now, it is the Commission's judgment that if the problems which are involved in this litigation have been canvassed, as they have by Messrs. Brickley and Hoar and Langenbach, and if a settlement has been negotiated as between them and the Paper Company and its representatives at arm's length, and a result of a ten million dollar cash payment has been reached, together with the three million dollar commitment for the Hudson River loan; that it reaches an area of very wide discretion and judgment as to whether that is an offer which should be accepted or rejected.

"I am certain that I can assure the court that there would be no difficulty on the Commission's part in recommending approval of the settlement for a sum substantially in excess of ten million dollars. And I think that candor requires me to say as well, perhaps not so vehemently, that it wouldn't be possible to say that a figure which had been reached which was somewhat less than ten million dollars was unacceptable. The acceptable figure lies, as I said a moment ago, in a pretty broad area. What I do say is that it is the view of the Commission that ten million dollars plus the other commitments brings this settlement within the area where it can be and should be approved."

At page 463:

"* * * And so I say and urge that the Court should look at this settlement from the point of view of the

IHES as a corporate entity—not from the point of view, not exclusively from the point of view, of whether the proceeds of the settlement will percolate down to any particular class of security holders in amount sufficient to make a settlement attractive to them."

POINT IV.

The action of the District Court is presumptively right, and should not be set aside unless clearly shown to have been wrong. In approving the settlement, the Court below was bound to take into consideration not only the prospects of recovery, but also the delay, which naturally results from protracted litigation, and the great expense incidental thereto.

The action of the District Court in approving the settlement has every presumption in its favor and the burden of proving it wrong is on the appellants.

In *re Prudence Co., Inc.,* 98 Fed. 2d 559, certiorari denied *Stein* v. *McGrath,* 306 U. S. 636 in which the writer of this brief appeared for the appellant, the District Court had approved a compromise of the claim against the estate of a bankrupt. In affirming, the Circuit Court of Appeals for the Second Circuit stated:

> "The district court did not determine the validity of the government's claim with respect to the taxability of the 'commissions'; nor need this court do so. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues, as this court pointed out in the case of In re Riggi Bros. Co., 2 Cir., 42 F. 2d 174, 176" (p. 560).

In *Re Riggi Brothers, Inc.,* 42 Fed. 2nd 174, decided by the Circuit Court of Appeals, Second Circuit, a decree of

the district court approving a compromise settlement was affirmed and the court *inter alia* stated (p. 176):

> "The approval of this compromise settlement is not to be tested wholly by what may now be thought would have been the result of litigation to settle the respective claims of the parties. It is certain that litigation for that purpose would have been the inevitable result of a failure to compromise and equally certain that it would have made for delay and expense. This should be kept in mind in reviewing the approval of the compromise. Petition of Stuart (C. C. A.) 272 F. 938-941. Coupled with the certainty of litigation was the uncertainty of its result and the soundness of the exercise of discretion in approving it largely depends upon how substantial was this element of uncertainty. The action of the District Court is presumptively right, and will not set aside unless clearly shown to have been wrong. Pullman Coach Co. v. Eshelman (C. C. A.) 1 F. (2d) 885, 887, 888. Consequently, we shall make no attempt to decide with exactness what would have been the outcome had no settlement been made and approved. Any virtue which may reside in a compromise is based on doing away with the effect of such a decision. For present purposes it is enough to consider only what was reasonably to be expected to happen had no agreement been made * * *"

and at page 177:

> "It is quite enough now to know that the trustee would have met with serious opposition in trying to free the property from the mortgage lien. While he might, perhaps, have succeeded, the nature of the legal problems involved was such that the expense, delay, and likelihood of failure may well have made a compromise settlement advisable."

There can be no doubt that should the proposed settlement fail to be consummated, there would ensue protracted and expensive litigation, since the issues are extremely involved. Nor is there any certainty that the result of such litigation would be such as to justify rejection of the proposed compromise.

POINT V.

Petitioners have failed to adduce sufficient proof of probative value to support their objections to the recommendations of the trustee and the Securities and Exchange Commission.

Aside from the documents and records introduced upon the hearing, appellants did not come forward with any evidence through testimony of witnesses or other proof in order to establish that the proposed settlement was unfair.

If, as appellants contend, the amount of the proposed settlement is wholly disproportionate to the amount of the recovery they expected to obtain, they might well have called expert witnesses to testify to an appraisal of the market values of the properties transferred to Hydro in the transactions complained of and to show to what extent the prices paid by Hydro exceeded such market values, and whether the profits, if any, that accrued to International Paper were unconscionable.

Such witnesses, if produced, could have been cross-examined by those interested parties appearing in support of the proposed compromise who might have also produced witnesses upon the same issue in their own behalf. Failing so to do appellants left the question of the amount possibly recoverable in the realm of speculation. In the absence of such testimony appellants have failed to overcome the presumption that attaches to the action of the court below.

CONCLUSION.

The proceeding here was not the trial of a case on its merits, but the consideration of a proposed compromise. We have noted the divergent views of different counsel with respect both to the enforceability of the claims of Hydro and the advisability of the proposed settlement.

In view of the great lapse of time, the defenses of the Statute of Limitations, ratification and laches interposed by International Paper, should be given due consideration. Nor may one regard lightly the pending motions by International Paper to dismiss for lack of jurisdiction. The District Judge, who has had jurisdiction of the proceedings from their inception and who, in the course thereof had every opportunity to acquaint himself with the contentions of the parties and the factual and legal issues involved, had sufficient basis upon which to exercise his discretion.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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